

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

FEDERAL DEPOSIT INSURANCE CORPORATION,
as Receiver for the Bank of North Idaho, Inc.,
substituted for the BANK OF NORTH IDAHO,
INC., a Corporation, *Appellant,*

vs.

MERLE C. MYHRE AND BETTY A. MYHRE,
husband and wife, *Appellees.*

*Upon Appeal from the District Court of
the United States for the District
of Idaho, Northern Division*

BRIEF OF APPELLANT

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No. 15130

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JURISDICTIONAL STATEMENT

The jurisdiction of the District Court of the United States for the District of Idaho, Northern Division, was invoked pursuant to the provisions of Title 28, United States Code, Section 1332. The Appellees were citizens of the State of Washington, and the Appellant was a citizen of the State of Idaho, viz., a banking corporation organized and existing under the laws of the State of Idaho (R. 7). The amount in controversy exceeded the sum of \$3,000, exclusive of interest and costs.

The jurisdiction of this Court to review this case arises under Title 28, United States Code, Sections 1291 and 1294, this being an appeal from a final decision of a District Court of the United States from which an appeal may be taken to this Court (R. 4).

STATEMENT OF THE CASE

This action was instituted in the District Court of the United States by the Appellees, residents of the State of Washington, against the Bank of North Idaho, Inc., an Idaho banking corporation, seeking to recover damages for the alleged wrongful conversion of personal property. While the action was still pending there, but before trial, the bank, having become insolvent, was taken over by the Commissioner of Finance of the State of Idaho and the Appellant, Federal Deposit Insurance Corporation, was appointed its receiver, pursuant to the provisions of Section 26-1403 of the Idaho Code (Appendix 20). Upon showing duly made, Federal Deposit Insurance Corporation, as such receiver, was substituted as party defendant (R. 13). The suit arose out of the following circumstances.

The Bank of North Idaho, Inc., located in Priest River, Idaho, loaned Appellees Fifteen Hundred Dollars, evidenced by their promissory note, dated November 10, 1954, which note was secured by a chattel mortgage (R. 8). Upon default in the terms of the note Appellees executed a bill of sale in favor of the bank conveying to it the property covered by the mortgage, with certain exceptions, under an agreement which provided that the property would be sold by the bank at the best price obtainable; that the bank would retain such sums as might be necessary

to pay Appellees' indebtedness and return to them any property not sold or any excess proceeds from the sale (R. 9). The property was delivered to the bank pursuant to the terms of the agreement and was sold by it. However, no excess proceeds were turned over to Appellees, nor was any of the property returned to them in kind (R. 10).

The case was heard before the court, who found in favor of Appellees, assessing damages in the sum of \$5,184.46, together with interest thereon at the rate of 6% per annum from May 1, 1954 to date of judgment, making a total judgment of \$5,728.78 (R. 5), which was entered against the receiver.

Over Appellant's objection, the court designated the amount of its above judgment as a trust fund and directed the receiver to give it priority in payment as such a trust fund (R. 6) under Section 26-915, Idaho Code (Appendix 23).

The questions involved are:

1. The judgment is not entitled to a priority as a trust fund since it is neither responsive to the issues raised by the pleadings nor supported by the evidence offered by Appellees.
2. The court was without authority or jurisdiction to direct the receiver to give the judgment

statutory priority as a trust fund under Section 26-915, Idaho Code.

The questions arise by reason of the proposed findings of fact and conclusions of law submitted to the court by Appellees (R. 7), the objections thereto by Appellant, and the overruling of said objections by the court (R. 37).

SPECIFICATIONS OF ERROR

I.

The action at bar is in personam. It was not one seeking to impress a trust upon specific property or a specific fund or to trace trust property into assets in the hands of the receiver of the Bank of North Idaho, Inc., a closed banking institution.

II.

The court erred in making the following findings:

“The Court further finds that the Defendant upon taking possession of the Plaintiff’s property involved in this action became a trustee of such property and by reason for (sic) such status and the conversion of such property by the Defendant, the judgment granted herein is entitled to a priority as a trust fund” (R. 11).

over Appellant’s objections (R. 36) that (a) the court in making such finding acted beyond its jurisdiction or authority, and (b) the finding is not within the issues raised by the pleadings.

The court erred in incorporating the following in its decree:

“IT IS FURTHER ORDERED, ADJUDGED AND DECREED, that the money judgment here-

by awarded is entitled to the priority as a trust fund in the order of payment of the debts of the original Defendant, Bank of North Idaho, a Corporation, and that the Defendant as Receiver shall allow this judgment such priority'' (R. 6)

over Appellant's objections (R. 36) that (a) the court in entering such decree acted beyond its jurisdiction or authority, and (b) such decree is not within the issues raised by the pleadings.

ARGUMENT

I.

NO FUNDS OR PROPERTY OF THE APPELLEES WERE TRACED INTO THE HANDS OF THE RECEIVER AND THEREFORE THE JUDGMENT ENTERED IN THIS CAUSE IS NOT ENTITLED TO PRIORITY IN PAYMENT AS A TRUST FUND.

An examination of the complaint filed in the action (R. 13-33) discloses that substantially the following allegations are made therein:

Appellees borrowed Fifteen Hundred Dollars from the Bank of North Idaho, Inc.; to secure that indebtedness Appellees gave a chattel mortgage to the bank, which, however, failed to adequately describe the mortgaged property; because of this defect Appellees later gave the bank a bill of sale to the property (with certain exceptions, not important here) accompanied by a written agreement which provided, inter alia, that the bank was to sell the property at the best price obtainable, deduct all sums owing to it and turn over the excess to them; the property delivered to the bank thereunder had a value of \$8,000 in excess of the amount owed by Appellees; a formal notice was served on the bank request-

ing a report of the disposition of the property and an accounting of the sale; in response thereto the bank advised Appellees that, while the details of the sale of the property were not necessarily of their concern, the chattels were sold for \$1,000.

On these allegations Appellees sought, as the gravamen of their complaint, money damages in the amount of \$8,000 by reason of the alleged wrongful conversion of the property.

It can thus be seen that nowhere in the complaint were any allegations made touching in any respect on the question of trust funds or the tracing of trust funds into the hands of the receiver, nor was any such relief sought. Even conceding that the evidence established the above allegations, a reading of the findings of fact (R. 7-12) will disclose that no findings were made from the evidence offered by Appellees to justify the court's decreeing that "the Defendant as Receiver shall allow this judgment such priority." (R. 6).

It is the well-settled majority doctrine that in order to entitle a claimant to a preference or priority in payment with respect to the assets of a bank in the hands of a receiver, it must be shown that the assets in the receiver's hands have been augmented or benefited by the trust fund. (7 *Am. Jur. Banks*, Sec. 788)

This doctrine has been adopted and consistently followed by the Idaho courts. (*Bellevue State Bank v. Coffin*, 22 Ida. 210, 125 P. 816; *Cox v. St. Anthony Bank & Trust Co.*, 41 Ida. 776, 242 P. 785; *U. S. Nat'l. Bank of Portland v. Standrod & Co.*, 42 Ida. 711, 248 P. 16; *National Bank of the Republic v. Porter*, 44 Ida. 514, 258 P. 544; *Uyeda v. Diefendorf*, 54 Ida. 614, 34 P. (2d) (65.)

In the Porter case the Supreme Court of Idaho stated the rule as follows:

"In construing this act of the Legislature, *1 this court has laid down the rule that, in order to impose a trust upon the property of a defunct bank in the hands of its receiver, where the rights of others are involved, the person seeking to establish the trust must trace the fund, or the property into which it has been converted, into the hands of the receiver. And where the fund has been so commingled with the property of the defunct bank as to render its tracing or identification impossible, he must show that the fund, in some tangible way, augmented, or bettered, the estate coming into the possession of the receiver, before he can impress a trust upon any portion of said estate * * *."

"The burden of tracing the trust fund into the hands of respondent was on the cestui que trust, appellant, 39 Cyc. 532; *Lusk D. & I. Co. v. Gintner*, 32 Wyo. 294, 232 P. 518. If, by reason of its having been commingled with the assets of the bank, the fund could not be traced, the burden

*Idaho Code, Section 26-915 (Appendix 23).

was still on appellant to show that fund had augmented or increased the assets of the Citizens' State Bank, of Buhl, coming into respondent's possession."

In the *Cor* case the court stated:

"That plaintiff was a trust creditor does not, of itself, entitle him to preference over general creditors. To obtain that right, he must show, by presumption of law or otherwise, that his fund has been preserved in the hands of the assignee, as an increase of the assets of the estate, from which it may be taken without impairment of the rights of general creditors."

In the case at bar there was a total failure on the part of the Appellees to bring themselves within the provisions of the above stated principle. Having wholly failed to allege or prove the identity or the amount of any property of the Appellees which came into the hands of the receiver or to trace into or identify in the hands of the bank's receiver the proceeds of any trust fund or in any way show the augmentation of assets in the receiver's hands, it is submitted on this state of the record that there was nothing presented to the trial court to entitle Appellees to a judgment in the action granting them the priority in payment of a trust fund out of the receivership estate.

II.

THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF IDAHO, IN ENTERING A JUDGMENT AGAINST THE RECEIVER OF AN IDAHO BANKING CORPORATION, WAS WITHOUT JURISDICTION OR AUTHORITY TO ASSIGN SUCH JUDGMENT A STATUTORY PRIORITY AS A TRUST FUND.

The trial court in its findings of fact (R. 11) found that

“the Defendant upon taking possession of Plaintiffs’ property involved in this action became a trustee of such property and by reason for (sic) such status and conversion of such property by the Defendant, the judgment granted herein is entitled to a priority as a trust fund.”

and determined in its judgment (R. 6).

“that the Defendant as receiver shall allow this Judgment such priority.”

Section 26-908 of the Idaho Code (Appendix 19) deals with the powers of the commissioner of finance on closing a state bank. It provides in substance that the commissioner is authorized to collect all monies due to such bank and to do such other acts as are necessary to conserve its assets and business, and that

he shall proceed to liquidate its affairs. He has general and exclusive power and authority to do any and all acts, to take any and all steps necessary or, in his discretion, desirable for the protection of the property and assets of the bank and the payment of its creditors.

Section 26-1403 of the Idaho Code (Appendix 20) authorizes the Federal Deposit Insurance Corporation to act as receiver of an Idaho banking institution and grants to it, as such receiver, all the rights, powers and privileges provided by the Idaho laws with respect to the commissioner of finance acting as receiver or liquidator of a banking institution.

Section 26-915 of the Idaho Code (Appendix 23) fixes the order of payment of the debts of a bank liquidated by the commissioner as follows: 1) expenses of liquidation; 2) all funds held by the bank in trust; 3) debts due depositors; 4) contractual liabilities; 5) interest on all foregoing classes of claims; and 6) unliquidated claims for damages and the like.

Section 26-913 of the Idaho Code (Appendix 22) deals with the allowance and rejection of claims and provides that *the commissioner* shall reject or allow all claims in whole or in part, and on each claim allowed *shall designate the order of its priority*. If a claim is rejected or an order of priority allowed

lower than that claimed, notice of his action shall be given to the claimant. The action of the commissioner shall be final unless an action be brought by the claimant against the bank in the proper court of the county where the bank is located within ninety days after notice of rejection of the claim or the fixing of its priority, or an appeal from the commissioner's allowance, either as to priority or amount, may be taken to the district court of the county in which the bank is located within thirty days after the allowance; and the court or judge shall hear proof of the parties and enter judgment reversing, affirming or modifying the commissioner's action.

That the present action may be maintained in the federal court is not here called into question, but it is respectfully submitted that in such an action the judgment rendered in the federal court proceeding merely determines the legal existence of *the amount of the claim* against the receivership. Even if it were to be conceded that the court properly found, under an adequately pleaded and proved case, that the amount due the Appellees by virtue of the judgment here under consideration constituted a trust fund, it is asserted that that court is without authority to classify the statutory order of priority of the claim. By virtue of the Idaho statute last above referred to, this power is vested exclusively in the commissioner of finance (here Appellant as his designee), whose

decision is final, subject only to review by the district court of the county wherein the bank is located and in the manner set forth in the statute.

In *Bybee v. D. W. Standrod & Co.*, 44 Ida. 708, 260 P. 157, which was a suit to recover deposits alleged to have been accepted by a bank while insolvent, the Supreme Court of Idaho stated, in reference to the liquidation of a bank in the hands of the commissioner:

“The controlling question in this case is whether or not Chap. 42, Sess. Laws 1921, provides an exclusive method of recovery by a claimant against an insolvent bank in the hands of the bank commissioner. * * * * The purpose of Laws 1921, c. 42, is to sequester the assets of an insolvent bank and place them for purposes of liquidation in the hands of the commissioner of finance to be by him administered for the benefit of all claimants, *such method of liquidation to be exclusive.*” (Emphasis supplied)

In *Lloyd v. Diefendorf*, 54 Ida. 607, 34 P. (2d) 53, the court considered specifically Section 25-915 of the Idaho Code (Appendix 23), and in that case stated:

“And the controlling question here, is, Does our Bank Act, *supra*, provide an exclusive method of recovery by a claimant against an insolvent bank in the hands of the commissioner of finance? It is clear to our minds that the Bank Act, *supra*, was intended to, and does, constitute a complete system for the organization, regulation, and

liquidation of state banks, covering the entire field, and every phase and ramification thereof * * * and is exclusive.”

The *Lloyd* case quotes from the United States Supreme Court in *Cook County National Bank v. U. S.*, 107 U. S. 445, 2 S. Ct. 561, 27 L. Ed. 537, in which case the court considered the provisions of the National Bank Act and compared that Act with the Idaho Bank Act which contains similar provisions. Part of that quotation is as follows:

“We consider that Act as constituting by itself a complete system for the establishment and government of national banks prescribing the manner in which they may be formed * * * their liability to be placed in the hands of a receiver, and the manner in such event in which their affairs shall be wound up * * * or their property applied toward such payment. Everything essential to the formation of the banks * * * the winding up of the institutions and the distribution of their effects are fully provided for as in a separate code by itself.”

It can thus be seen that the sole authority to designate the order of priority of claims against an insolvent state banking institution of the State of Idaho is vested in the Commissioner of Finance, and therefore the District Court of the United States, in granting the subject judgment a priority as a trust fund, and directing the receiver to allow it as such a claim against the receivership, usurped the right exclusively granted by statute to the Commissioner (here to Ap-

pellant as his designee), and therefore acted without authority. The classification of such a claim is subject to judicial action, in the event an order of priority is allowed lower than that claimed, only in the district court of the county wherein the bank is located, and in either of two ways, i.e., (1) an appeal to that court by the aggrieved party from the commissioner's classification or (2) a plenary action brought against him in that court. For this reason, it is submitted that that portion of the judgment of the District Court of the United States granting the subject judgment a statutory priority and directing the receiver to allow it such priority is ineffective and unenforceable.

CONCLUSION

It is asserted that for the reasons herein stated the trial court (a) was in error in decreeing that the judgment herein entered should be granted a priority as a trust fund and directing the payment thereof by the receiver out of funds of the receivership estate and (b) was without authority to grant the judgment a priority as a trust fund under the provisions of Section 26-915 of the Idaho Code. It is therefore submitted that in accordance with the foregoing this honorable court should modify the judgment of the District Court of the United States for the District of Idaho entered in favor of the Appellees and against the Appellant by eliminating therefrom the provision (R. 6) that the judgment is entitled to the priority as a trust fund in the order of payment of the debts of the original defendant, Bank of North Idaho, Inc., and the provision that the Appellant, as receiver, shall allow it such priority.

Respectfully submitted,

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A P P E N D I X

APPLICABLE PROVISIONS OF
IDAHO BANK ACT

Idaho Code Section 26-908. Powers of Commissioner on Closing Bank. "Upon taking the assets and business of any bank into his possession, the commissioner is authorized to collect all moneys due to such bank, and to do such other acts as are necessary to conserve its assets and business, and he shall proceed to liquidate the affairs thereof. He shall have general and inclusive power and authority, except as otherwise limited by the terms of this act, to do any and all acts, to take any and all steps necessary, or, in his discretion, desirable for the protection of the property and assets of such bank and the speedy and economical liquidation of the assets and affairs of such bank and the payment of its creditors, or for the reopening and resumption of business by said bank, where that is practicable or desirable. He may institute, in his own name as commissioner, or in the name of the bank, such suits and actions and other legal proceedings as he deems expedient for such purposes, and by making application to the district court of the county in which such bank is located, or to the judge thereof, in chambers, may procure an order to sell, compromise or compound any bad or doubtful debt or claim, and to sell and dispose of any or all the assets, which sale may be made to stockholders, officers, directors, or

others interested in such bank, on consent of the court. On such court proceedings the bank shall be made a party by notice issued on order of the court or judge, in lieu of summons, but served in like manner, and the hearing of any such application or petition by the commissioner may be had at any time, either in term or vacation in court, or in chambers, as the court may order, after said bank has had five days' notice of such application."

Idaho Code Section 26-1403. F. D. I. C.—Right to Act as Receiver or Liquidator. "The Federal Deposit Insurance Corporation created by section eight of the Federal 'Banking Act of 1933' (Section 12B of the Federal Reserve Act, as amended) [U. S. C. (4 F. C. A.) tit 12, §264] is hereby authorized and empowered to be and act without bond as receiver or liquidator of any banking institution, the deposits in which are to any extent insured by said corporation, and which shall have been closed on account of inability to meet the demands of its depositors, in lieu of the commissioner of finance, but only if and when requested so to do by said commissioner."

"The commissioner of finance may, in his discretion, in the event of such closing tender to said corporation the appointment as receiver or liquidator of such banking institution, in his stead, and if the corporation accepts said appointment, the corporation shall have and possess all the rights, powers and

privileges provided by the laws of this state with respect to the commissioner of finance acting as receiver or liquidator of a banking institution, and be subject to all the duties of such receiver or liquidator, except insofar as such rights, powers, privileges or duties are in conflict with the provisions of subsection of section 12B of the Federal Reserve Act, as amended (section 8 of said 'Banking Act of 1933')."

"The Corporation shall not, however, without the consent of the commissioner of finance, continue to act as receiver or liquidator of any banking institution after the amount of the insured deposit liability of such banking institution, paid or assumed by the corporation, and the costs of liquidation paid or assumed by it have been repaid it, or after funds are available therefor."

Idaho Code Section 26-1407. Possession and Control of Assets by F. D. I. C. "Upon the acceptance of the appointment of receiver or liquidator aforesaid by said corporation, and during its continuance as such receiver or liquidator, the possession and control of all the assets, business and property of such banking institution of every kind and nature shall pass to and vest in said corporation and without the execution of any instruments of conveyance, assignment, transfer or endorsement, with the same force and effect and to the same extent as in the commissioner of finance under like circumstances."

Idaho Code Section 26-913. Claims—Allowances and Rejection. “The commissioner shall reject or allow all claims in the whole or in part, and on each claim allowed shall designate the order of its priority. If a claim is rejected or an order of priority allowed lower than that claimed, notice shall be given the claimant personally or by registered mail, and an affidavit of the service of such notice, which shall be prima facie evidence thereof, filed in the office of the commissioner. The action of the commissioner shall be final unless an action be brought by the claimant against the bank in the proper court of the county where the bank is located within ninety days after such service to fix the amount of the claim and its order of priority or either. An appeal from the commissioner’s allowance, either as to priority or amount, may also be taken to the district court of such county by any party in interest by serving on the commissioner notice thereof, stating the grounds of objection and filing the same in said court within thirty days after allowance. Within five days after such notice, the commissioner shall file in the court, and serve on the appellant, a copy of the claim and his reasons for allowance. The court or judge shall, after five days’ notice of time and place of hearing on the issues thus made, hear the proof of the parties and enter judgment reversing, affirming or modifying the commissioner’s action.”

Idaho Code Section 26-915. Claims—Order of Payment—Priorities—Offsets. "The order of payment of the debts of a bank liquidated by the commissioner shall be as follows:

1. The expense of liquidation, including compensation of agents, employees and attorneys.

2. All funds held by bank in trust.

3. Debts due depositors, holders of cashier's checks, certified checks, drafts on correspondent banks, including protest fees, paid by them on valid checks or drafts presented after closing of the bank, pro rata. All deposit balances of other banks or trust companies and all deposits of public funds of every kind and character (except those actually placed on special deposit under the statutes providing therefor) including those of the United States, the state of Idaho, and every county, district, municipality, political subdivision or public corporation of this state, whether secured or unsecured, or whether deposited in violation of law or otherwise, are included within the terms of this subdivision and take the same priority as debts due any other depositor; anything in the statutes of the state of Idaho to the contrary notwithstanding. Provided, however, that this section shall not apply to any deposit made by this state or any county thereof, city, town or district of this state prior to the twenty-eighth of February, 1921.

4. All contractual liabilities pro rata.

5. Interest on all foregoing classes of claims without regard to the priority of the principal computed as follows:

Savings accounts at the same rate they bore at the time of the closing of the bank until the next regular date for the computation and crediting of the interest thereon, and thereafter at the rate of seven per cent per annum; time certificates of deposit at the rate fixed in the certificate until the same becomes due by their terms, and thereafter at the rate of seven per cent per annum; all other contractual obligations bearing interest at the rate they bore at the time of closing until due by their terms, and thereafter at seven per cent per annum, and those not bearing interest, at the rate of seven per cent per annum from the time when said bank came into the possession of the commissioner; no interest to be compounded.

6. Unliquidated claims for damages and the like.”